



CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

June 5, 1998

H.R. 3150 **Bankruptcy Reform Act of 1998**

As reported by the House Committee on the Judiciary on May 20, 1998

SUMMARY

H.R. 3150 would make many changes and additions to the laws relating to bankruptcy, including establishing a system of means-testing for determining eligibility for relief under chapter 7 of the U.S. bankruptcy code. CBO estimates that implementing H.R. 3150 would increase discretionary spending by \$214 million over the 1999-2003 period, subject to appropriation of the necessary funds. The bill also would affect direct spending and governmental receipts, so pay-as-you-go procedures would apply. We estimate that the net annual impact on direct spending would be negligible. CBO estimates that one provision (in Title I) would increase receipts by about \$3 million a year. Other provisions (in Title V) also would affect receipts, but the Joint Committee on Taxation (JCT) has not completed an estimate of such changes at this time.

CBO also estimates that implementing the means-testing provisions could require additional judges to accommodate the anticipated increase in workload of the federal court system. Because the salaries and benefits of bankruptcy judges are considered mandatory, adding more judges would increase direct spending. CBO estimates that mandatory costs for additional judges would cost between \$2 million and \$4 million annually. But H.R. 3150 would not authorize additional judgeships, so the means-testing provisions in the bill would not—by themselves—affect direct spending. An additional \$6 million to \$12 million annually in other costs for personnel and administrative expenses of the courts associated with additional judgeships would be subject to the availability of appropriated funds. If new judgeships were not added, these provisions would lead to a backlog of cases rather than increased costs.

H.R. 3150 contains no intergovernmental mandates as defined by the Unfunded Mandates Reform Act, and most of the provisions in the bill would enhance the ability of state and local governments to collect outstanding obligations. The changes to bankruptcy law in the bill would affect state and local governments primarily as creditors and holders of tax or

child support claims against debtors. The bill contains private-sector mandates as defined in UMRA, but CBO has not yet completed an analysis of the effects on the private sector.

DESCRIPTION OF THE BILL'S MAJOR PROVISIONS

In addition to establishing means-testing for determining eligibility for chapter 7 bankruptcy relief, Title I would require the Executive Office for the United States Trustees (U.S. Trustees) to establish a one-year pilot program to educate debtors on financial management. Title II would place additional duties on the U.S. Trustees in cases involving small businesses. Title IV would:

- require that at least one out of every 100 bankruptcy cases under chapter 13 or chapter 7 be audited by an independent certified public accountant;
- require the U.S. Trustees to receive and maintain tax returns for all chapter 7 and chapter 13 debtors;
- exempt chapter 11 debtors from having to pay certain fees in connection with their bankruptcy cases; and
- require the U.S. Trustees to collect and publish certain statistics on bankruptcy cases.

Title V would make various changes affecting the treatment of tax liabilities in bankruptcy cases. Other titles of the bill would make changes to bankruptcy provisions affecting municipalities and would create a new bankruptcy chapter for transnational bankruptcy cases.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

As shown in the following table, CBO estimates that implementing H.R. 3150 would cost \$22 million in 1999 and \$214 million over the 1999-2003 period, mostly for the increased workload of the U.S. Trustees. Additional revenues from filing fees would total \$15 million over five years. The table does not include potential costs of \$8 million to \$16 million a year that would result if additional judgeships were created to accommodate the added burdens on the federal court system. The costs of this legislation fall within budget function 750 (administration of justice).

	By Fiscal Year, in Millions of Dollars				
	1999	2000	2001	2002	2003
CHANGES IN SPENDING SUBJECT TO APPROPRIATION					
Means-Testing Litigation ^a (Sections 101-103)					
Estimated Authorization Level	2	2	2	1	1
Estimated Outlays	2	2	2	1	1
Debtor Financial Management Training (Section 112)					
Estimated Authorization Level	2	0	0	0	0
Estimated Outlays	2	0	0	0	0
U.S. Trustee Site Visits (Section 240)					
Estimated Authorization Level	2	2	2	2	2
Estimated Outlays	2	2	2	2	2
Audit Procedures (Section 404)					
Estimated Authorization Level	0	10	21	25	31
Estimated Outlays	0	8	19	24	30
Maintain Tax Information (Section 406)					
Estimated Authorization Level	6	5	6	7	9
Estimated Outlays	5	5	6	7	9
Elimination of Quarterly Filing Fees (Section 413)					
Estimated Authorization Level	9	10	10	10	10
Estimated Outlays	9	10	10	10	10
Data Compilation/Publication (Sections 441 and 443)					
Estimated Authorization Level	2	6	8	8	9
Estimated Outlays	2	5	8	8	9
Total Changes					
Estimated Authorization Level	23	35	49	53	62
Estimated Outlays	22	32	47	52	61

a. To avoid an increased backlog of cases, additional judgeships would have to be created to handle an expected increase in bankruptcy courts' workload. CBO estimates that the increase in direct spending would be between \$2 million and \$4 million a year, for salaries and benefits of judges, but those costs would be contingent upon enactment of future legislation authorizing additional judgeships. We also estimate that administrative support for additional judgeships would increase discretionary costs by \$6 million to \$12 million annually, but those costs would also be contingent upon enactment of future authorizing legislation.

BASIS OF ESTIMATE

For purposes of this estimate, CBO assumes that H.R. 3150 will be enacted by October 1, 1998, and that all estimated authorization amounts will be appropriated for each fiscal year.

Spending Subject to Appropriation

Most of the estimated increases in discretionary spending would be required to fund the additional workload that would be imposed on the U.S. Trustees. Currently, the U.S. Trustees are funded through the bankruptcy-related fees collected by the courts. Without additional statutory authority, these fees cannot be increased to cover any expenditures or loss of offsetting collections that would occur under the bill. Because the legislation does not provide for such increases in fees, any additional costs would be subject to the availability of appropriated funds.

Means-Testing (Sections 101-103). The means-testing provisions in H.R. 3150 would specify that an individual is not eligible to be a chapter 7 debtor if the individual has income available to pay creditors. The ability to pay creditors would be determined by applying various calculations to the debtor's income, living expenses, and debts. Other expenses could be excluded from what would be defined as "available income" if the debtor could prove certain "extraordinary circumstances." Also, creditors would be able to move to have a chapter 7 case dismissed, though they would have to pay for the debtor's attorney's fees and litigation costs if the motion to dismiss the case was denied and not substantially justified.

Under H.R. 3150, CBO estimates that the U.S. Trustees would be required to compile and review income data necessary for means-testing and to participate in any litigation that would result from issues concerning eligibility. CBO expects that any additional data collection requirements would not pose a significant burden on the U.S. Trustees and thus would require no additional appropriations. However, we expect that the U.S. Trustees would incur additional costs for the work that would result from increased litigation.

Based on information from the U.S. Trustees, CBO expects that the bill's means-testing provisions could increase litigation over a debtor's eligibility for chapter 7 relief because of potential conflicts between the courts and debtors over what constitutes "extraordinary expenses." Under the bill, additional motions for dismissal would result because more objective criteria would be applied to a debtor's income and expenses and because creditors would have the ability to challenge petitions for chapter 7 relief. Some debtors whose

petitions for chapter 7 relief would be denied under H.R. 3150 would undoubtedly appeal those decisions.

Although CBO cannot predict the amount of such litigation, we expect that, during the first few years following enactment of H.R. 3150, the amount of litigation could be significant, as parties test the new law's standards. We expect that the U.S. Trustees, who would become gatekeepers to the bankruptcy system under the bill, would be heavily involved in any litigation that would occur, at a cost of about \$2 million annually through 2001. In subsequent years, we expect that litigation would diminish as precedents are established, and we estimate that costs would decrease to about \$1 million annually.

Debtor Financial Management Training Test Program (Section 112). This section would require the U.S. Trustees to establish a one-year pilot program to educate debtors on financial management. The pilot would occur in three judicial districts; bankruptcy judges in those districts would have the authority to require debtors to undergo this training as a condition of receiving relief from certain debts. Based on information from the U.S. Trustees, CBO estimates that about 45,000 debtors would take part in this pilot program and that the cost per debtor would average about \$40. Thus, we estimate that the U.S. Trustees would require an appropriation of about \$2 million in 1999 to establish such a program.

U.S. Trustee Site Visits in Chapter 11 Cases (Section 240). This section would expand the responsibilities of the U.S. Trustees in small business bankruptcy cases to include site visits to inspect the debtor's premises, review records, and verify that the debtor has filed tax returns. Based on information from the U.S. Trustees, CBO estimates that the U.S. Trustees would require 20 additional analysts to conduct over 2,300 site visits each year. CBO estimates that the U.S. Trustees would require an appropriation of about \$2 million annually for the salaries, benefits, and travel expenses associated with these additional personnel.

Audit Procedures (Section 404). Beginning 18 months after enactment, H.R. 3150 would require that at least one out of every 100 bankruptcy cases under chapter 7 and chapter 13, plus other selected cases under those chapters, be audited by an independent certified public accountant. The U.S. Trustees estimates that about 1.2 million cases would be subject to audit in fiscal year 2000, increasing to about 1.8 million in fiscal year 2003. Assuming that 1.25 percent of all cases would be audited and that each audit would cost about \$1,200 (in 1998 dollars), implementing this provision would require appropriations of \$10 million in fiscal year 2000 and \$87 million over the 1999-2003 period.

Maintenance of Tax Returns (Section 406). This section would require the U.S. Trustees to receive and retain the tax returns for the three most recent years preceding the commencement of the bankruptcy case for all chapter 7 and chapter 13 debtors (about

7 million debtors over 1999-2003 period). Based on information from the U.S. Trustees, CBO estimates that appropriations of \$33 million over the next five years would be required to store and provide access to over 20 million tax returns.

Elimination of Certain Chapter 11 Fees (Section 413). This section would require chapter 11 debtors whose disbursements are less than \$300,000 to pay quarterly fees only until their case is converted or their plan is confirmed (whichever occurs first), beginning on October 1, 1999. Currently, these debtors pay quarterly fees even after their plan has been confirmed. These fees are recorded as offsetting collections to the U.S. Trustee System Fund and are available for spending from that account. According to the U.S. Trustees, about 3,590 cases would be affected by this provision each year and, on average, the government collects about \$650 per quarter per case each year. Thus, by shortening the period during which fees are paid, the bill would reduce annual fee collections by \$9 million to \$10 million beginning in fiscal year 2000. Because this loss of offsetting collections would reduce the amount available for spending by the U.S. Trustees (for overall supervision and administration of bankruptcy cases), CBO estimates that the U.S. Trustees would require an appropriation of \$9 million in fiscal year 1999 and \$49 million over the next five years to compensate for the loss of quarterly filing fees.

Compilation and Publication of Bankruptcy Data and Statistics (Sections 441-443). H.R. 3150 would require the U.S. Trustees to collect and publish certain statistics on Chapter 7, 11, and 13 cases and to make these data available to the public. Based on information from the U.S. Trustees, CBO estimates that appropriations of about \$33 million would be required over the 1999-2003 period to meet the requirements under these sections. Of the total estimated cost, about \$22 million would be required over the next five years for legal clerks, analysts, and data base support. The remainder of the estimated cost (\$11 million) would be incurred for compiling data and providing Internet access to records pertaining to bankruptcy cases.

Direct Spending and Revenues

Means-Testing (Sections 101-103). CBO estimates that enacting the means-testing provisions would impose some additional workload on the courts. Although the U.S. Trustees would be responsible for conducting the initial review of financial information under either bill, CBO expects that the courts would also be involved in some level of review of such data. In addition, many bankruptcy judges expect that additional hearings and other court proceedings would be held over eligibility and income data.

To address the workload increase that we expect under this bill, either the courts would operate within current personnel levels, resulting in a backlog of cases, or the Congress would have to authorize additional judgeships. Currently, about one million chapter 7 cases are filed each year and about one million cases are closed each year, with about 500,000 cases pending at any given time. CBO estimates that judges' salaries and benefits, which are not subject to appropriation, would average about \$152,000 a year (in 1998 dollars) and that discretionary expenditures associated with a judgeship (support personnel and other administrative expenses) would average about \$400,000 a year, after certain initial costs. Currently, there are 326 judgeships authorized in 94 districts.

CBO estimates that between 15 and 30 additional bankruptcy judges would be required to meet the increased workload requirements that would be imposed on the courts under H.R. 3150. If those judgeships were established, costs for the salaries and benefits of judges would be between \$2 million and \$4 million annually, which would represent an increase in direct spending, and costs for support personnel and other administrative expenses would be between \$6 million and \$12 million annually, which would be subject to appropriation. These estimates assume that about 5 percent of all chapter 7 cases filed would require, on average, less than an hour of additional time of judges and court personnel, that about 10 percent of all chapter 7 cases (about 96,000 out of 960,000 cases) would instead be filed as or converted to chapter 13 cases, and that at least 5 percent of all chapter 7 debtors would not file for any type of bankruptcy protection. CBO does not expect costs to reach their full level for several years because it takes time to appoint judges.

With a reduction in chapter 7 filings, the government would lose income from chapter 7 filing fees. CBO estimates that for each case that would not be filed under chapter 7 or any other chapter, there would be a \$130 reduction in the filing fee paid to the government. Income from this fee appears in two different places in the budget. Of the \$130, \$70 is recorded as part of the offsetting collections to the U.S. Trustee System Fund and the Judiciary, and \$15 is recorded as governmental receipts (i.e., revenues). Under chapter 7, the remaining \$45 is paid to the private trustee assigned to the case and does not affect the federal budget. Assuming that fees for about 48,000 cases would be no longer be collected each year, CBO estimates that enacting H.R. 3150 would result in a loss of about \$1 million a year in revenues and about \$3 million in offsetting collections. The loss of offsetting collections would reduce the amount available for spending by the U.S. Trustees and the Administrative Office of the United States Courts; however, CBO estimates that no additional appropriations would be required to replace this projected loss of fees because it would be matched by a reduction in workload associated with these chapter 7 cases.

The shift of cases from chapter 7 to chapter 13 would, in contrast, lead to greater fee collections. In contrast to the distribution of fees under chapter 7, \$60 of the \$130 filing fee

is collected as a governmental receipt under chapter 13. (Private trustees are not paid out of the filing fee under chapter 13.) Thus, the government collects an additional \$45 for each shift of a case from chapter 7 to chapter 13. Because CBO expects that about 96,000 chapter 7 cases would be filed as or converted to chapter 13 cases, we estimate that revenues would increase by about \$4 million in each year. On balance, the net change in revenues would be an increase of about \$3 million each year.

Tax Provisions (Title V). The provisions in H.R. 3150 are currently under review by the Joint Committee on Taxation, and estimates of their effects on revenues will be provided when they are completed.

PAY-AS-YOU-GO CONSIDERATIONS

Section 252 of the Balanced Budget and Emergency Deficit Control Act sets up pay-as-you-go procedures for legislation affecting direct spending or receipts. Both Titles I and V would affect receipts; hence, pay-as-you-go procedures would apply. The net changes in governmental receipts for Title I are shown in the following table. Enacting Title I would result in fewer chapter 7 debtors filing for bankruptcy protection and more debtors filing for chapter 13 protection. As a result, CBO estimates a net increase in revenues of about \$3 million each year. (JCT is reviewing Title V and has not yet completed an estimate of its effects on receipts.)

The bill also would affect direct spending, but we estimate that the net annual impact would be negligible. For the purposes of enforcing pay-as-you-go procedures, only the effects in the current year, the budget year, and the succeeding four years are counted.

	By Fiscal Year, in Millions of Dollars										
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Changes in outlays	0	0	0	0	0	0	0	0	0	0	0
Changes in receipts ^a	0	3	3	3	3	3	3	3	3	3	3

a. Estimated impact of Title I. JCT has not completed an estimate of changes in receipts for Title V.

Also, as mentioned above, CBO estimates that if additional judgeships were authorized to meet the increased workload requirements under this bill, the mandatory costs for the salaries and benefits of judges would be \$2 million to \$4 million annually. However, enacting this bill by itself would not authorize such positions, and thus would not affect direct spending.

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

H.R. 3150 contains no intergovernmental mandates as defined by the Unfunded Mandates Reform Act, and most of the provisions in the bill would enhance the ability of state and local governments to collect outstanding obligations. The changes to bankruptcy law in the bill would affect state and local governments primarily as creditors and holders of tax or child support claims against debtors.

H.R. 3150 would require debtors to file tax returns before a bankruptcy case can proceed. It would give greater priority to child support obligations owed to states and municipalities, and it would increase the likelihood that governments will collect delinquent taxes. States would also be given authority to enforce new requirements on agencies that provide debt relief counseling.

Tax Payment Plans. The bill would require that payment plans for tax liabilities be limited to six years and that payment amounts be regular and proportionate to payments for other obligations. Under current law, taxing authorities sometimes face payment plans that include a series of small payments over time followed by a large balloon payment near the end of the planned payment stream. At that point, the debtors often fail to complete their obligations, and taxing authorities lose a disproportionate share of their claims. This provision would require that taxes be paid at a rate proportionate to those of other debts. It also would establish interest rates to be applied to outstanding tax liabilities. Under current law, any interest changes on outstanding tax liabilities are determined at the discretion of the bankruptcy judge.

Time Limits on Tax Collection. Under some circumstances, a tax claim can qualify for priority status, and thus a state and local government would be more likely to collect the debt. However, this status is granted only if a tax is assessed within a specific period of time from the date of the bankruptcy filing. If that filing is subsequently dismissed and a new filing is made, the tax claim may lose its priority status. The bill would make adjustments to this provision, allowing more time to pass in some circumstances, thus increasing the likelihood that state or local tax claims would maintain their priority status.

Taxes and Administrative Expenses. Under current law certain expenses can be paid out of funds that would otherwise be available to pay tax liens on property. The bill would restrict the use of funds for administrative expenses to a limited number of circumstances, thereby making it more likely that funds would remain available to cover tax obligations.

Tax Return Filing and Government Notification. A number of provisions in the bill would require debtors to have filed tax returns, and in some cases to be current in their tax

payments, before a bankruptcy case may continue. Also, debtors would be required to provide notice to state authorities in a specific manner when they pursue relief under bankruptcy law. These provisions would help states identify potential claims in bankruptcy cases where they may be owed delinquent taxes.

Enforcement of Debt Relief Counseling Agency Requirements. The bill would create a number of requirements for agencies that provide debt relief counseling, and it would allow a state to bring an action against any agency that violates those requirements.

Child Support. Child support payments owed to states or municipalities would be nondischargeable; that is, those obligations would continue to be a liability for the debtor even after the bankruptcy is completed. Child support obligations owed to governments would also be given priority for payment on the same basis as other support and alimony payments owed to spouses and children.

Priority of Payments. In some circumstances, debtors have borrowed money or incurred some new obligation that is dischargeable (able to be written-off at the end of a bankruptcy) to pay for an obligation that would not be dischargeable. This bill would give the new debt the same priority as the underlying debt. If the underlying debt had a priority higher than that of state or local tax liabilities, state and local governments could lose access to some funds. However, it is possible that the underlying debt could be for a tax claim, in which case the taxing authority would face no loss. Because it is unclear what types of non-dischargeable debts are covered by new debt and the degree to which this new provision would discourage such activity, CBO can estimate neither the direction nor the magnitude of this provision's impact on state and localities.

Homestead Exemptions. Federal bankruptcy statutes currently allow states to determine certain property exemptions in bankruptcy cases. The bill would place limits on the value of homes that may be exempted from bankruptcy claims and would increase the length of time a property has to be a primary residence in order to qualify as an exempt property. While this provision may limit the application of some state laws, it may also free up additional resources in cases where a state or local government may have an outstanding tax claim.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

H.R. 3150 contains private-sector mandates as defined in UMRA, but CBO has not completed its analysis of the effects on the private sector.

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